

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

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**Federal Communications Commission
Office of Secretary**

WT Docket No. 97-82

In the Matter of

**Amendment of Part 1 of the
Commission's Rules --
Competitive Bidding Proceeding**

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To: The Commission

**COMMENTS OF
MERLIN TELECOM, INC.**

MERLIN TELECOM, INC.

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SUMMARY

These Comments address Merlin Telecom, Inc.'s ("Merlin") concerns about the effects that the Federal Communications Commission's ("FCC" or "Commission") proposed changes to its Part 1, Subpart Q auctions rules could have on small businesses.

Merlin opposes the Commission's proposals to eliminate installment payments, raise the down payment percentages paid by auction winners planning to use installment payments, and raise the interest rates on installment payments. Merlin's opposition stems from the adverse result these changes would have on small businesses. Specifically, each of the proposals would cause small businesses to face a higher cost of capital, which would make it harder for small businesses to offer spectrum-based services.

Merlin also opposes the Commission's proposal to reduce the percentages of bidding credits it offers to small business bidders. Reduced bidding credits will create higher barriers to entry into the marketplace for small companies trying to compete with existing, large telecommunications service providers. Section 309(j) of the Communications Act requires the Commission to take action to ensure that licenses are disseminated to a wide variety of applicants, including small businesses. Many of the FCC's proposals conflict with this mandate and should not be adopted.

Merlin offers proposals for how the FCC should evaluate the companies that will be considered affiliates and attributable investors of an auction applicant. Merlin suggests that the FCC adopt a rule which permits limited liability companies to exclude non-managerial members of the company from being attributed to the applicant, just as the Commission has traditionally allowed a publicly traded corporation to exclude all but its controlling shareholders from attribution.

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Merlin Telecom, Inc. ("Merlin"), by its attorneys, hereby respectfully submits these Comments in response to the *Order, Memorandum Opinion and Order and Notice of Proposed Rule Making ("Order and NPRM" or "NPRM")*, released by the Federal Communications Commission ("FCC" or "Commission") on February 28, 1997, in WT Docket No. 97-82. These Comments oppose the FCC's proposals to: (1) eliminate installment payments; (2) raise the interest rates for installment payments; (3) lower the percentages of bidding credits offered to small businesses; and (4) increase the percentages of down payments that designated entities must make.

I. STATEMENT OF INTEREST

Merlin is a telecommunications consulting firm primarily engaged in assisting small companies to participate in FCC auctions and to build and operate telecommunications systems. Merlin currently represents over twenty (20) applicants for upcoming narrowband

PCS license auctions. Merlin has played an integral part in the business and strategic planning for the potential applicants it represents. Merlin's clients have requested that it file these Comments to ensure that small businesses are treated fairly and consistently by the FCC's Rules. As discussed below, Merlin is extremely concerned that the FCC's tentative conclusions regarding auction rule changes will have a detrimental effect on small businesses, particularly those small businesses who have already made business plans in reliance on the existing rules.

II. DISCUSSION

A. PAYMENT ISSUES

1. Merlin conditionally supports the FCC proposal to pre-screen installment payment candidates.

In the *NPRM*, the FCC generally seeks comment on ways to "streamline" its installment payment plan while continuing to offer opportunities to small businesses to provide spectrum based services. *NPRM* at para. 34. The Commission seeks comment on whether it should evaluate, or screen, auction applicants to determine their credit-worthiness and on the standards that should be applied if the Commission chooses to screen applicants. *NPRM* at para. 34.

Merlin conditionally supports the Commission's proposal to pre-qualify auction participants who wish to use installment financing and bidding credits. Small businesses which are serious about offering new spectrum-based services will be able to demonstrate that they have sufficient financial backing to participate in the auction and that they qualify for the

designated entity provisions for which they claim eligibility. Pre-qualification should help reduce the potential for fraud. However, Merlin opposes any pre-qualification provision which would limit the ability of a newly formed small business to avail itself of the FCC's installment payment plans. Pre-qualification should not be used by the FCC to determine whether newly formed small businesses are credit worthy. The purpose of installment payments is to enable smaller companies which traditionally lacked access to capital to start new enterprises. 47 U.S.C. § 309(j). *See also* Implementation of Section 309(j) of the Communications Act - Competitive Bidding, *Second Report and Order*, 9 FCC Rcd 2348 (1994). ("*Competitive Bidding Second Report and Order*") The availability of installment payments helps to disseminate licenses to a wider variety of businesses, including newly formed small businesses, consistent with Congress' statutory mandate set forth in Section 309(j) of the Communications Act of 1934, as amended ("the Act").

Smaller businesses which lack access to capital need to avail themselves of installment payment plans in order to participate in these new services. Any pre-qualification of applicants should not be undertaken with the intention of precluding an auction winner from using installment financing. The current rules, under which an auction winner only needs to meet financial caps to be allowed to use installment payments, should remain the qualifying criteria.

2. Merlin opposes proposals to eliminate installment payment plans.

The Commission also stated that it may eliminate its installment payment plan altogether, and substitute a system of larger bidding credits instead. *NPRM* at para. 34.

Merlin vehemently opposes this notion and submits that it is contradictory to the Commission's previous conclusions. In the *Competitive Bidding Fifth Report and Order*,¹ the Commission stated that:

A significant barrier for most businesses small enough to qualify to bid in the entrepreneurs' block will be access to adequate private financing to ensure their ability to compete against larger firms in the PCS marketplace. (citation omitted) In the Second Report and Order, we concluded that installment payments are an effective means to address the inability of small businesses to obtain financing and will enable these entities to compete more effectively for the auctioned spectrum. We also determined that small businesses eligible for installment payments would only be required to pay half of the down payment . . . after the auction closes. . . . Finally, we indicated that installment payments should be made available to small businesses at an interest rate equal to the rate for U.S. Treasury obligations.

Competitive Bidding Fifth Report and Order at para. 135. Additionally, the Commission found that a moratorium on the payment of principal in the early years of the loan would increase the chances that small businesses have of obtaining licenses, and it would allow small businesses "to concentrate their resources on infrastructure build-out and, therefore, it will increase the likelihood that they become viable PCS competitors." *Id.* at para. 140.

¹ In the Matter of Implementation of Section 309(j) of the Communications Act - Competitive Bidding, *Fifth Report and Order*, PP Docket No. 93-253, 9 FCC Rcd 5532 (1994) ("*Competitive Bidding Fifth Report and Order*").

Merlin strongly opposes replacing the installment payment plan with higher bidding credits. While significant bidding credits can be useful in helping smaller entities win licenses when they bid against larger companies, bidding credits alone do not help the smaller companies access the start-up capital needed to offer spectrum based services. A combination of bidding credits and installment payments is the most efficacious means for the FCC to ensure the wide dissemination of licenses and to meet its statutory obligation under Section 309(j) of the Act by ensuring the participation of smaller companies in new wireless services.²

a. Small businesses have relied on FCC rules and the Act in developing their business plans.

There are several other business reasons for maintaining the current installment payment and bidding credit plans. Currently, there are scores of businesses which have been preparing to participate in upcoming FCC auctions. Each business has been waiting for the auction of licenses in the service it feels it can most competitively offer. In formulating business plans to adequately prepare for the auction, each of these small companies has been relying on the language of the current rules as well as the language of Section 309(j) to guide them in preparing for the conditions they will face at and after an auction. Specifically, they have been relying on the availability of installment payments. If the FCC were to eliminate its installment payment plan at this point, all the well-laid plans of those small businesses would be rendered useless. If the FCC is facing difficulty in administering its installment payment program -- a fact still very much in doubt -- it would be wiser to re-work the

² 47 U.S.C. §§ (309)(j)(3)(4).

process for administering installment payments rather than to unduly burden or even eliminate the smallest new entrants into the communications marketplace. The change wrought by suddenly depriving small business applicants of installment payments, thus forcing them to raise significantly more capital on short notice, could effectively preclude small businesses from participating in the FCC's future auctions altogether. Because the FCC was directed to ensure that small businesses and women- and minority-owned businesses are able to participate in the new auctioned services, the FCC would be abrogating its statutory obligation as well as its responsibility to serve the public interest if it were to eliminate its installment payment plan.

b. Eliminating installment payments raises issues of regulatory parity and headstart.

Additionally, there is a fundamental unfairness which would result from elimination of installment payments at this point. The early auction participants who already have a licensing and construction headstart in many auctionable services, including narrowband PCS and broadband PCS, had and will continue to have the ability to pay for licenses using installment payments. Many of the early auctions were for geographically defined areas which were larger than some of those areas still to be licensed. This fact is particularly prevalent in narrowband PCS, where the major trading area (MTA) licenses and basic trading area (BTA) licenses are to be auctioned well after the nationwide and regional licenses. Any small company which had difficulty accessing capital might have quite rationally waited to participate in the auction of licenses which are smaller and require less upfront money.

However, these smaller companies still need the assistance provided by deferred license payments which enable them to use scarce capital resources for build-out of their systems and provision of service to the public early in the license term. If the Commission insists on collecting funds for the U.S. Treasury immediately, small businesses will not be able to build and operate their newly-won systems because the capital raised will go to pay for the license. The result is that small businesses will have difficulty constructing and marketing their new services and may be forced to transfer their licenses at fire-sales, putting the new entrants out of business before they really have an opportunity to get started.

c. Eliminating installment payments raises the cost of capital.

The Commission's proposal to eliminate installment payments also has the deleterious effect of raising the cost of capital faced by small businesses. To be precise, the more money a small company needs to borrow from commercial lenders to make an immediate payment to the FCC, the higher the interest rate that small company will face from commercial lenders. This will increase the overall cost of the capital to the small business, and it will increase the cost of the license. This artificial barrier to capital that the Commission's proposal creates will have the effect of lowering the bid prices on licenses. It will also inordinately favor existing large companies, *simply because they are large*. This approach is antithetical to the requirements of Section 309(j) of the Act.

Moreover, it flies in the face of the effective strategies that the financial and business communities have recommended the Commission take to ensure greater competition in the

marketplace. In fact, the lending community has encouraged the FCC to defer repayment of installment payments until the end of the license term, in a balloon payment, which would allow licensees who originally lacked capital to finance the license separately from the construction and operation of their systems.³ A successful small business would then be able to borrow to make the balloon payment at the end of the license term by relying on its track record in the new business. The public would be substantially better off because the likelihood of default would lessen.

The system of installment payments creates all the incentives the FCC is seeking. Commercial lenders have continuing incentives to ensure that they lend to viable entrepreneurs and to see that those companies operate in compliance with the FCC's rules. Lenders need to ensure that there is no default which could cause the license to be revoked. At the same time, new licensees will introduce more competition without the fierce demand on their scarce capital resources posed by immediate payment requirements at the FCC. This would bring more competitive choices to the public, with the attendant additional innovation, while preserving greater likelihood that a licensee would have a chance to succeed in the new business. If, as time passes, a licensee is forced to default to the government, the existence of a constructed and operating system will ensure that the public -- through the government -- is better able to collect on its license because the sale of a constructed system always generates

³ See e.g. Petitions for Reconsideration and/or Comments filed in PP Docket No. 93-253 after release of the *Fifth Memorandum Opinion and Order*, 10 FCC Rcd 403 (1994), Comments of NCFC Capital, Mellon Bank, Petition for Reconsideration filed by National Telecom.

more money than the transfer of a bare license. Thus, by continuing to permit small businesses to pay for licenses using installment payments, the government will continue to fulfill the mission set out in Section 309(j) of the Act.

d. Administrative convenience does not justify eliminating installment payments.

The FCC's rationale for allowing Broadband PCS C and F block applicants to utilize installment payments can be applied equally to future auctions. The realities of the marketplace have not changed. In the *NPRM* the FCC has given no explanation as to why its installment payment plan needs streamlining. Therefore, the rationale the Commission embraced in the *Competitive Bidding Fifth Report and Order* should not be abandoned just for the sake of administrative convenience. Instead, the FCC can streamline the processing of installment payments, create coupon books, or find other ways to cure its administrative problems.

3. Merlin opposes any proposal to increase auction down payments.

Seeking ways to reduce the risk of default, the FCC seeks comment on whether it should require higher down payments from auction winners who seek to make their payments under an installment payment plan. Requiring small businesses to put more money upfront will not reduce the likelihood of default. In fact, the reverse is true. Requiring more money upfront will increase the likelihood of default since more cash will be tied up in the license and less will be available to construct and operate the system.

a. Higher down payments harm small businesses.

By suggesting that down payments be increased, the FCC implies that defaults are intentional. To Merlin, this suggestion that defaults are intentional, volitional acts by auction winners is ludicrous. The FCC's very premise is not just suspect, it is wrong. First, there are already severe penalties which an auction winner faces when it defaults on a license.

47 C.F.R. § 1.2109. Also, no auction participant would voluntarily spend thousands and thousands of dollars, and hundreds and hundreds of man-hours participating in an auction only to intentionally default on a license, thereby incurring more financial burdens without accruing any benefit.

The primary cause of defaults is that a licensee lacks sufficient liquidity to make full payment at the time the FCC demands the payment. Then, the licensee is unable to find new sources of capital to fill in the gaps. In fact, the most stunning defaults occurred when seemingly secure financing evaporated shortly before an auction ended. *See In Re BDPCS*, May 1996.⁴ Despite BDPCS' search for back-up financing, the licensee was unable to secure

⁴ In *BDPCS*, a winning bidder on over 15 licenses lost its financial backing less than a week before the C block auction ended. BDPCS searched for a new lender to provide a bridge loan to help it meet its \$36 million payment obligation, but it was unable to secure back-up financing. If the FCC had a higher down payment requirement in effect, BDPCS still could not have forced its lender to make the bridge loan. With a higher down payment percentage in effect, more winning bidders probably would have faced the same fate. This is not the result of poor planning by bidders, nor a sign of their lack of financial qualification, it is the result of the vagaries of the commercial money market. Additionally, the Order denying BDPCS's waiver request relied on the existing rules to say that if the down payment had been met, the auction winner would have demonstrated its financial qualification to hold a license. The *NPRM* does not give any reason why that demonstration is no longer valid.

another commitment to make the 5% down payment it owed on total bids of over \$800 million, the down payment required by the FCC's rules for the Broadband PCS C block. If the FCC had required BDPCS to make *more* than a \$40 million down payment, it would *not* have been *less* likely to default, it would have defaulted just the same. In fact, it is the case that *more* licensees would default if the initial capital requirements for down payments were increased.⁵ The higher the down payment percentage, the less likely that an applicant will be able to secure back-up financing if its original financing falls through. If the FCC is concerned about reducing the incidence of default, it should not increase the amount of its down payment.

b. Increasing down payments raises the cost of capital to small businesses.

The FCC should not increase the down payment percentages because it would raise the cost of capital to small business auction participants. Increases in the upfront cost of licenses will cause smaller auction participants to borrow even more money from commercial lenders. The greater the demand for money, the higher the interest rates the borrowers face. Additionally, without the benefit of deferred payments represented by smaller down payments and installment payments, the debt ratios of small business auction participants will be highly

⁵ In *C.H. PCS, Inc.*, D.A. 96-1273, Auctions Division, released August 9, 1996, the chief of the Auctions Division denied an auction winner's request for an extension time to file its down payment. The bidder in a re-auction of licenses had a financial commitment from Daewoo Corporation which withdrew the commitment a day before the auction closed. The Commission does not waive its payment deadlines because financial backers renege on their commitments. Neither the FCC nor a winning bidder can force a lender to lend down payment money. Therefore, the FCC should not increase the down payment percentages it sets because the end result would be to create more defaults not fewer.

unfavorable for those businesses. Commercial lenders look at the amount of debt a company has, the amount of equity it has, and its potential earning capacity to determine how much it can lend the company. The more immediate payments a potential borrower has to make, the lower the chance the company will have to use borrowed capital to earn the ability to repay the loan. Thus, if a borrower owes large sums, especially in the near term, this causes the commercial lender to protect its capital by charging a higher interest rate.⁶ Therefore, higher down payments paid to the FCC will cause higher capital costs to small businesses.

Designated entities were so designated to help ensure that they would participate in the provision of spectrum based services. The changes being considered by the FCC in these proposed rules will defeat Congress's stated purpose. In doing so, the FCC will not achieve its own aim of reducing the level of defaulting bidders. Thus, the public and small business applicants will be worse off.

The FCC should not increase the down payment amount to be made after an auction is over in order to protect itself against licensees who later default. The Commission has another remedy. It can ensure against default because the licensee's greatest asset, its license, is cancelable if the licensee later does not comply with the license terms, including making timely payment to the government. The asset is not impaired over time, as is often the case with assets which are used to secure commercial loans. Spectrum is not a depreciable good, because the spectrum remains viable for use at any time. The FCC, as the licensing

⁶ In fact, lenders have created loans with balloon payments to help borrowers with little capital to finance new ventures, such as home purchases, start up companies and more.

authority, can always license a new company without the risk of losing the asset, because it has not sold the spectrum as if it were property.

Moreover, the public interest is best served, and has been found for decades to be best served, when the spectrum is used to provide service to the public, rather than lying fallow. 47 C.F.R. §§ 151, 307. The FCC does not need large down payments to protect its right to reclaim the license or to protect the public interest. Therefore, by ensuring that capital is immediately directed to the construction and operation of a wireless subscriber based service, the FCC helps to ensure that the public interest is met, while it helps to promote the development of smaller businesses and entrepreneurs. This also increases the chance that the license will be paid for over time. Companies with customers and cashflow are far more likely to generate the income necessary to pay a loan. Also, these companies have the incentive not to abandon a licensed operating business because of the money, time and labor invested in the development of the business. By keeping the downpayment levels low, the FCC will increase the likelihood of payment. And, since the government does not need to borrow funds to make installment payments available, the Commission faces no cost of capital of its own which would otherwise be an argument against deferring payment.

4. Merlin opposes any proposal to increase installment payment interest rates.

The FCC has proposed to reduce the uncertainty surrounding interest rates on installment payments by setting a more definable date for when the interest rates will be

determined. This will be the day on which the FCC publicly announces the auction is closed. Merlin supports this change in the rules.

Additionally, the FCC is proposing to standardize its installment payment plan by reducing to a maximum of two years the amount of time that a licensee can make interest-only payments and raising the interest rates at which winning bidders make payments. *NPRM* at para. 36. Section 1.2110 of the Commission's Rules sets the installment payment interest rate generally at the Treasury Note rate. The Commission has now proposed increasing that amount by between 1.5 and 3.5 percent for all but the smallest companies. While the Commission's rationale is that it offered a bargain before, *NPRM* at para. 36-38, there is no reason why it should get a mark-up on the cost of capital. The Treasury Note rate is the cost of capital to the government. As Merlin explained above, the FCC does not need to go to capital markets to borrow money to finance these installment payments. Thus, any percentage over the rate of a Treasury Note is pure profit to the government. It is an additional surcharge being visited upon only the smaller auction participants, not the larger bidders. This flies in the face of the goal of helping smaller businesses. The government is not entitled to profit off the hard work of small companies. Accordingly, Merlin supports keeping the interest rates at their original, reasonable levels.

a. Higher interest rates at the FCC raise the cost of capital.

Raising the interest rate on installment payments raises the cost of capital for small business auction participants. Small business auction participants will have greater overall

debt liability if they face higher interest rates from the government. In that case, commercial lenders will raise the rates that small businesses pay for capital because the chances of default to them increase as the amount of debt increases.⁷ Every time the FCC increases payments and rates, the cost of capital to small businesses increases because the demands on their scarce capital resources is higher. The FCC was instructed by Congress to help break down the barriers to accessing capital faced by small businesses, women- and minority-owned businesses. This proposed rule change raises a barrier Congress instructed the FCC to reduce. Therefore, the Commission should not adopt this proposal.

B. MERLIN OPPOSES THE REDUCTION OF BIDDING CREDITS

The FCC proposes that the bidding credits it offers to small businesses be reduced from the rates which have become customary in auctioned services. In the Regional Narrowband PCS auction, women- and minority-owned businesses were entitled to bidding credits of 40 percent to discount the cost of licenses. While the standard bidding credit has

⁷ A commercial lender's need to protect against loan defaults is very different from the FCC's need to protect against default on a license. The FCC as the licensing authority can always re-auction a license if the original auction winner does not fulfill its payment obligations, thus ensuring that it will recoup for the public a portion of the value of the spectrum. The government has no opportunity cost for which it needs immediate repayment. It does not face any out-of-pocket costs for issuing the license which would require immediate repayment. A commercial lender, in contrast, has to choose between lending to a variety of borrowers. It has shareholders and bank regulators which dictate the kinds of borrowers and returns that the lender must select. Therefore, the commercial lender faces limitations on its ability to defer repayment of a loan - especially from the FDIC. Also, because the commercial lender cannot take a security interest in a license, it cannot seize the primary asset of a borrower to protect the money it has lent out, which it needs to recoup. Thus, the interests of the government and commercial lenders are *very different* and the rationale for protecting repayment to commercial lenders does not suffice to justify the government raising interest rates or down payments on licenses.

generally not exceeded 25 percent for other auctionable services, the 25 percent bidding credit has been available to small businesses with average gross revenues for the last three years of \$40 million or less. Now, the FCC is proposing to standardize its rules so that companies with average gross revenues of \$40 million or less for the last three years will only be able to use a 10 percent bidding credit (a 60 percent reduction in the benefit); companies with average gross revenues of \$15 million or less will only be able to use a 15 percent bidding credit; and only companies with average gross revenues of \$3 million or less will be able to use the 25 percent bidding credit which has helped so many small businesses get started in offering spectrum based services.

Merlin believes that the levels of bidding credits should be higher than those proposed in the *NPRM*. Originally, the FCC offered bidding credits to help level the playing field between smaller bidders and larger bidders participating in the same auction. For a truly small company to participate in an auction successfully against a company like Sprint or AT&T, the small company needs a large bidding credit to even enter the arena. A bidding credit acts to ensure that the bidder who values the license most highly wins the license, because the bidder using a bidding credit actually bids the highest amount for the license. This is an efficient outcome, which the FCC claims to desire. *See, e.g. Competitive Bidding Second Report and Order; Competitive Bidding Fifth Report and Order*. However, the amount that the winning bidder pays for the license is discounted by the percentage of the bidding credit to which the bidder is entitled. Experience has shown that by severely reducing the size of bidding credits available to small business auction participants, the FCC

will virtually eliminate the possibility that small businesses will win licenses at auction. As a result, small businesses will not have a chance to provide spectrum-based services.⁸

Merlin suggests that companies with average gross revenues of \$3 million or less for the last three years be entitled to use a bidding credit of 40 percent instead of the bidding credits proposed by the FCC. This will help ensure that the smallest companies have a fair chance to compete in an auction with companies that are significantly greater in size. Companies with average gross revenues of \$15 million or less for the last three years should be entitled to a bidding credit of 35 percent, and companies with average gross revenues of \$40 million or less should be entitled to a bidding credit of 25 percent. This will help ensure that small businesses have a fair shot at winning licenses in an auction. The definition of small businesses will be appropriately tailored to the particular type of licenses which will be offered at the auction. This will help more companies participate in auctions and help the public to recover a portion of the value of the spectrum being auctioned, ensuring that the parties who value the spectrum the most will hold the licenses and develop new radio services.

Equitably, the FCC should be committed to higher bidding credits because reducing this benefit now would harm small businesses who have not yet had a chance to participate in

⁸ In the *Competitive Bidding Fifth Report and Order*, the FCC discussed the fact that bidding credits cannot help very small businesses compete against Fortune 100 companies unless those credits are greater than 50%. At para. 131. The FCC fails in the *NPRM* to demonstrate that its earlier findings should be changed.

an auction. The first auction winners who were designated entities not only got licenses, a headstart in building systems, and the chance to "cream skim" customers, they also received substantial bidding credits from the Commission. To reduce benefits at this point would not only be unequitable, it would be arbitrary and capricious. It would be arbitrary because the FCC has not provided reasons for its proposals in the *NPRM*. It would be capricious because it would treat similarly situated auction participants differently for no reason.⁹ The FCC has a legal obligation not to act arbitrarily or capriciously. 5 U.S.C. § 706.

Moreover, it would be fundamentally unfair to reduce the level of bidding credits at this time because it would unreasonably burden small businesses which were waiting for new services or smaller geographic areas to participate in the auction of new services. Not only would new entrants face the original high barriers to entry into spectrum-based services, they would be at a competitive and financial disadvantage when compared to similarly situated companies that started just two years ago.

C. MERLIN GENERALLY SUPPORTS STANDARDIZING AFFILIATION AND ATTRIBUTION RULES

The FCC proposes to create a standard measurement by which an applicant can determine which of its investors will be attributable to the applicant and which other companies will be considered affiliates of the applicant. The Commission proposes to

⁹ The FCC has an obligation to treat similarly situated parties similarly or to provide "adequate justification for disparate treatment." *McElroy Electronics v. FCC*, 990 F.2d 1351, 1365 (D.C. Cir. 1993).

abandon its use of bright line "control group" structures that it developed for Narrowband and Broadband PCS auctions to determine if an applicant qualifies to bid as a small business. It proposes shifting to a review of the controlling principals of applicants and their affiliates. The Commission proposes to look at *de facto* and *de jure* control of the applicant as set forth in *Ellis Thompson Corp.* 76 Rad. Reg. (P&F) 1125 (1994) and *Intermountain Microwave*, 24 Rad. Reg. (P&F) 983 (1963). The Commission asks whether it should adopt the new Small Business Administration definition of affiliate which includes companies under common control, companies where one controls another, or is controlled by another, and companies with ownership, management, contractual ties to the applicant or previous ties to the applicant. *NPRM* at para. 29.

When the FCC created its publicly traded company exception to its small business rules for the Broadband PCS C block auction, it did not have experience with new business structures such as limited liability companies. The business community is changing to use new and more creative business structures which give applicants more favorable tax status while preserving the personal insulation from liability of a corporate structure. Yet, the new business entities are not corporations and, generally, the equity of the companies is not traded on an exchange. Therefore, for the Commission to treat these new business entities fairly, it needs to create rules which do not restrict the creativity of the entrepreneurs who will participate in auctions.

In response to the *NPRM*, Merlin proposes that the Commission eliminate its control group structures and shift to an attribution rule under which investors are not attributable to an applicant unless they have *de facto* or *de jure* control of the applicant. The Commission should give guidance to the business community regarding how to structure applicants to comply with this attribution standard. In setting out the guidelines, the FCC should be clear that its rules will be broadly written to adapt to various new business structures, such as limited liability companies ("LLCs") without forcing the new businesses to fit into archaic business structure patterns. For instance, a widely held LLC should not be required to be publicly traded, like a corporation is, because LLC membership units are created under state laws which prohibit them from being traded on public exchanges. Still, widely held LLCs should be treated by the FCC as if they were widely held companies, allowing them to exclude as attributable investors those equity holders who are not in control of the applicant, as envisioned by *Intermountain Microwave*. Specifically, in the case of a widely held LLC, its *controlling members* would be attributed to the applicant, and their affiliates would be counted toward the applicant, but non-controlling members would be excluded from attribution, just as if they were small, non-controlling shareholders in a widely held corporation. For purposes of defining whether a company is widely held, whatever its form of business organization, the FCC should write its rules to state that a widely held company is one in which no single equity holder would have 15 percent or more of the equity of the applicant. This is the standard used for publicly traded companies in Part 24 of the Commission's Rules. 47 C.F.R. § 24.720. The rest of the equity in a widely held company should be held by investors holding ten percent or less of the equity of the applicant.

Merlin proposes that the FCC create some safe harbors to give some certainty to the business community as it structures auction applicants. One such safe harbor would be to establish that an applicant whose equity is widely held, where no single equity holder holds 15% of the equity, and all the rest of the equity is widely held amongst nine or more other equity holders, could exclude all its owners from attribution. In such a situation, like that created for publicly traded corporations, only the affiliates of the governing body of the applicant would be attributed to the entity.

By permitting companies whose equity is widely held to exclude attributable investors, the Commission will make it possible for entrepreneurs to start small businesses which can participate in auctions without burdening the new companies with overwhelmingly onerous record keeping and reporting requirements. Thus, a small company with thirty or more investors, could vest control in a management team and still exclude the gross revenues of small, passive investors who are clearly not in control of the venture. Given the significant capital requirements for starting up spectrum-based businesses, small companies find it necessary to bring in many investors to generate sufficient capital to create a viable bidder. However, not all those investors will be active in the management and operation of the business. If an investor's holdings in the applicant are less than ten percent of the equity of the applicant, and the controlling LLC members, partners, or officers and directors have at least ten percent of the equity, it should be made clear in the rules that such an applicant will not have to attribute all of the assets and revenues of all of its investors to the applicant.